APPENDIX A

SETTLEMENT AGREEMENT

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities.	Investigation 07-01-022 (Filed January 11, 2007)
In the Matter of the Application of Golden State Water Company (U 133 E) for Authority to Implement Changes in Ratesetting Mechanisms and Reallocation of Rates.	Application 06-09-006 (Filed September 6, 2006)
Application of California Water Service Company (U 60 W), a California Corporation, requesting an order from the California Public Utilities Commission Authorizing Applicant to Establish a Water Revenue Balancing Account, a Conservation Memorandum Account, and Implement Increasing Block Rates.	Application 06-10-026 (Filed October 23, 2006)
Application of Park Water Company (U 314 W) for Authority to Implement a Water Revenue Adjustment Mechanism, Increasing Block Rate Design and a Conservation Memorandum Account.	Application 06-11-009 (Filed November 20, 2006)
Application of Suburban Water Systems (U 339 W) for Authorization to Implement a Low Income Assistance Program, an Increasing Block Rate Design, and a Water Revenue Adjustment Mechanism.	Application 06-11-010 (Filed November 22, 2006)

SETTLEMENT AGREEMENT BETWEEN THE DIVISION OF RATEPAYER ADVOCATES AND CALIFORNIA WATER SERVICE COMPANY ON WRAM & CONSERVATION RATE DESIGN ISSUES

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I. GENERAL

1) Pursuant to Article 12 of the Rules of Practice and Procedure of the California Public Utilities Commission ("Commission"), the Division of Ratepayer Advocates ("DRA") and California Water Service Company ("CWS " collectively, "the Parties") have agreed on the terms of this Settlement Agreement which they now submit for approval. This Settlement Agreement addresses conservation-oriented increasing block rates and related decoupling mechanism such as Water Revenue Adjustment Mechanism ("WRAM") and Modified Cost Balancing Accounts (MCBAs).

2) Since this Settlement Agreement represents a compromise by them, the Parties have entered into each stipulation contained in the Settlement Agreement on the basis that its approval by the Commission not be construed as an admission or concession by any Party regarding any fact or matter of law in dispute in this

proceeding. Furthermore, the Parties intend that the approval of this Settlement Agreement by the Commission not be construed as a precedent or statement of policy of any kind for or against any Party in any current or future proceeding. (Rule 12.5, Commission's Rules on Practice and Procedure.)

3) The Parties agree that no signatory to the Settlement Agreement assumes any personal liability as a result of their agreement. All rights and remedies of the Parties are limited to those available before the Commission.

4) The Parties agree that this Settlement Agreement is an integrated agreement, so that if the Commission rejects any portion of this Settlement Agreement, each Party has the right to withdraw. Furthermore, the Settlement Agreement is being presented as an integrated package such that parties are agreeing to the Settlement as a whole, as opposed to agreeing to specific elements of the Settlement.

5) This Settlement Agreement may be executed in counterparts, each of which shall be deemed an original, and the counterparts together shall constitute one and the same instrument.

II. BACKGROUND

1) CWS provides service to approximately 500,000 customers in twenty-four districts.

2) All of the residential customers in 15 districts have metered service connections, while the other 9 districts also have residential customers with flat-rate service connections. Attachment 1 shows all of Cal Water's districts and indicates the frequency of billing and the numbers of metered and flat rate residential customers.

III. TRIAL PROGRAM

1) The Parties agree that the conservation rate design and related decoupling mechanisms (WRAM and MCBA) constitute a Trial Program to become effective 90 days after a Commission decision adopting the proposed settlement.

2) This Trial Program will be reviewed in the next general rate case ("GRC") filing for each district. The filing dates are pursuant to the proposed decision in the Commission's Rate Case Plan rulemaking proceeding, R.06-12-016.

3) Unanticipated impacts of Trial Program: If implementation of the proposed Trial Program results in a disparate impact on ratepayers or shareholders, parties agree to propose adjustments so that customers and shareholders are equally at risk and share equally in any cost savings or excess revenue.

IV. RATE DESIGN – RESIDENTIAL CUSTOMERS

1) Overview:
    a. Conservation rate designs are proposed for 22 of CWS' 24 districts and consist of increasing block rates of two and three tiers.
        i. Two small districts and one sub-district do not have proposed conservation rates under this Trial Program as explained below.
    b. There are no proposed changes to meter charges.
    c. The tiers are based on the consumption patterns and seasonality of each district.
        i. Assumption for developing tiers: the proxy for indoor water use equals the midpoint between the median and the average winter use.

2) Grouping of the districts: For the purposes of designing conservation rates for residential customers districts were separated in three groups.
    a. Group 1: districts where all residential customers have metered service. This group is further sub-divided into two and three tiered rate structures.
    b. Group 2: districts where there are metered and flat rate residential customers. CWS has transition plans in place to move flat rate customers to metered service.
    c. Group 3: comprised of two small districts, Kern River Valley and Redwood Valley, plus the Fremont Valley sub-district in Antelope Valley.

3) Residential GROUP 1: Two-tiered and three-tiered increasing block rates.

    a. Three-tiered districts – districts with significant seasonal differences (in which the average summer use is more than twice the average winter use):
        i. Tier 1 – From zero to the midpoint between winter average and median consumption (this is the proxy for indoor water use). This ensures that consumers at low and average levels of consumption stay within Tier 1. The effect is to provide a 5% discount on water sold to customers whose usage stays within tier 1 consumption limits.
        ii. Tier 2 – From the top of Tier 1 to the mid-point between weather adjusted average monthly annual consumption and average summer consumption.
        iii. Tier 3 – All consumption above the top of Tier 2.

    b. Two-tiered districts – districts with <u>less</u> significant seasonal differences (average summer use that is less than twice average winter use).
        i. Tier 1 – From zero to the midpoint between winter average and median consumption (this is the proxy for indoor water use). This ensures that consumers at low and average levels of consumption stay within Tier 1 (The same as Tier 1 above in the three-tiered districts of Group 1.)
        ii. Tier 2 – All consumption above the top of Tier 1.

c. Rates for three-tiered districts – the general principles used are:
    i. The rate for the first tier (which approximates indoor water use) is discounted to be approximately 95% of the current single quantity rate.
    ii. The rate for the second tier is set at the current single quantity rate, except:
        1. The rate is adjusted up or down to achieve revenue neutrality. Revenue neutrality is defined as projected increasing block rate revenue that is within 100.5 % and 101% of revenues based on the single quantity rate that had been adopted in the most recent GRC.[1]
        2. If this adjustment does not achieve target revenues, the rate of the first tier is adjusted until revenues balance.
    iii. The rate for the third tier is set at approximately 20% above the second tier rate.
    iv. If the general criteria above does not achieve target revenues, the first tier is adjusted until revenues balance.[2]

d. Rates for two-tiered districts – the rate for the second tier is approximately 20% greater than the first tier rate.

e. For Group 1, the percent difference between the first and last tier is no more than 38.82%.

[1] For example, with the Bakersfield district, the initial revenue recovery was 99.55% with rate tiers at 0.95, 1.0 and 1.20. The second tier was adjusted to 1.03, resulting in projected revenue recovery of 100.61%.
[2] For example, in the West Lake district, the initial settings of 0.95, 1.03, and 1.2 resulted in over-recovery of revenue. Reducing the first tier to 0.85 and the second to 1.00 resulted in revenue recovery of 100.60%.

4) Residential GROUP 2: Districts with Metered and Flat Rate Customers
    a. Because these districts have a mix of flat rate and metered rate customers, increasing block rates cannot provide conservation price signals to all customers.
    b. Thus, the same criteria for designing rates for Group 1 was used for Group 2 with the exception that the percent difference between tiers was minimized.
    c. As customers are transitioned from flat to metered rates, more customers will encounter a conservation price signal.
    d. For Group 2, the percent difference between the first and last tier was somewhat less at 36.32% to account for the fact that not all customers are metered yet

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5) Residential GROUP 3: Areas with Small Numbers of Customers
    a. For the Kern River Valley, Redwood Valley, and the Fremont Valley sub-district in Antelope Valley, this Trial Program retains standard rate design, and does not propose increasing block rates or changes in the meter charge.
    b. The number of customers in these areas and their consumption is small relative to the size of the utility.
    c. Per customer average consumption is extremely low in these districts. In addition, existing single quantity rates are significantly high such that further conservation incentives through rate design are not necessary at this time to motivate customers to reduce their usage.
    d. The Commission recently adopted a Rate Support Fund (RSF) in D.06-08-011 to address water affordability in these districts where critical water infrastructure improvements are stressing the ability of these predominantly lower income communities to pay.[3] Implementing the RSF along with conservation rates could be confusing to customers and send conflicting price signals. It also makes developing a conservation rate design prohibitive within the timeline set in this proceeding. Parties agree to revisit this issue in the next GRC.

V. RATE DESIGN – NON-RESIDENTIAL CUSTOMERS

1) For non-residential customers in all districts, with the exception of Stockton[4], parties propose that a single quantity rate design be retained, with a reduction in the service charge which results in an increase in the quantity charge. Where appropriate, the single quantity rate for non-residential customers is based on meter size as explained below.

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[3] The RSF provides rate assistance subsidies of $20 per customer per month in Kern River Valley district, $8.50 per customer per month in the Fremont Valley service area, and in the Redwood Valley District it provides $17 per customer per month in the Lucerne rate area, $6.05 per Ccf (one-hundred cubic feet) in the Coast Springs rate area, and $1.76 per Ccf in the Unified rate area.

[4] Stockton customers currently have a two tier rate structure. The proposed non residential rate design lowers the service charges and increases the quantity charge, and results in two new tier 1 and tier 2 quantity rates, keeping the adopted proportion between tier one and tier two.

a. For the purposes of this Trial Program, non-residential customers are categorized into two rate groups:
    i. customers with meters 6" diameter and under, and;
    ii. customers with meters 8" diameter and over.[5]
b. Service charges are reduced by approximately 10% to 25%, with corresponding increases in the quantity rate to achieve revenue recovery neutrality.
c. Service charge reductions were calculated by reducing the meter charge to a point where no more than a 15% increase in the quantity rate for either of the two rate groups resulted.

2) Recovering more fixed costs in the quantity charge:

    a. For the purposes of designing conservation rates for non-residential customers, districts were separated into two groups based on the California Urban Water Conservation Council's (CUWCC's) Best Management Practices 11 (BMP 11)[6] threshold of a rate structure being conservation-oriented if more than 70% of revenue comes from the quantity charge.

    b. Group I consists of districts in which more than 70% of revenue comes from the quantity charge, and the existing quantity rate is more than $1.005/Ccf:
        i. For Group I districts, the reduction in the meter service charge ranges from 10% to 25%.
        ii. Non-Residential Group I is shown in Attachment 1.

    c. Group II consists of districts in which less than 70% of revenue comes from the quantity charge, and the existing quantity rate is low, defined as less than $1.005/Ccf:
        i. For Group II districts, the reduction in the meter service charge ranges from 12% to 15%.
        ii. Non-Residential Group II is shown in Attachment 1.

3) Other customer classes. Parties agree that rates for the following classes will not change: residential flat rate service, service to privately owned fire protection systems, metered recycled water service, and reclaimed metered service.

[5] In three districts, customers with 8" meters are included with the smaller meter sizes (those 6" or under). In these three districts, there were only 1 to 3 customers in the 8" meter group, and their consumption was low, even when compared to the consumption of customers with smaller (6" or less) meters.
[6] Best Management Practice 11, Conservation Pricing.

VI. MECHANISMS FOR DECOUPLING SALES AND REVENUE

1) Goals of the decoupling mechanisms in the Trial Program:
    a. Sever the relationship between sales and revenue to remove any disincentive for the utility to implement conservation rates and conservation programs.
    b. Ensure cost savings resulting from conservation are passed on to ratepayers.

2) Decoupling for CWS will be accomplished through both of the following mechanisms:
    a. A Water Revenue Adjustment Mechanism (WRAM) for each district.
    b. A Modified Cost Balancing Account (MCBA) for each district. MCBAs will replace existing cost balancing accounts for purchased power, purchased water, and pump tax.

VII. WATER REVENUE ADJUSTMENT MECHANISM (WRAM)

1) Each district will have a separate WRAM. The WRAM for each district will ensure recovery of the portion of CWS' fixed costs that are recovered through the quantity charge, and certain variable costs not included in the MCBA.[7]
    a. In general, under the current, traditional rate design, 50% of fixed costs are recovered in the meter charge (or service charge)[8]. The remaining 50% of fixed costs and 100% of variable costs are recovered through the quantity charge (or consumption or volumetric charge). Table (FC in QC) shows estimates of the current portion of fixed and variable cost recovered through the meter and quantity charges.[9]
    b. The fixed costs not included in the WRAM are recovered through the meter charge, which are monthly charges that customers pay regardless of consumption.
    c. The variable costs included in the WRAM are variable costs other than purchased power, purchased water, and pump tax, which are included in the MCBAs.

2) More specifically, the WRAM will track the difference between Actual Fixed Costs and Adopted Fixed Costs for the portion of the fixed costs recovered through the quantity charge (under the proposed rate design), and between certain Actual Variable Costs and Adopted Variable Costs not tracked in the MCBAs.

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[7] The MCBA will ensure recovery of actual costs for purchased water, purchased power and pump tax (*see* Section VII) and must be used in conjunction with the WRAM to accomplish revenue decoupling.

[8] The meter charge, or service charge, is a fixed monthly charge that is assessed on every customer. It varies by meter size.

[9] In CWS' rates and tariffs, the meter charge is defined as the "service charge," a readiness-to-serve charge that is charged to all metered service. It may also be called the "fixed charge". Not all rates in the CWS system have the ratio described as traditional ratemaking due to Commission approved allocations to minimize customer bill impacts.

This is accomplished by tracking the difference between actual and adopted sales, and multiplying that variance by the derived WRAM rate.

3) The WRAM rate is derived by dividing the sum of the fixed costs in the quantity rate and the non-MCBA variable costs by the total forecasted sales adopted in the last GRC. An illustration provided in Attachment 1 shows how the WRAM rate (on a $/Ccf) is calculated.

VIII. MODIFIED COST BALANCING ACCOUNT (MCBA)

1) The Modified Cost Balancing Accounts (MCBAs) will capture the cost savings and cost increases associated with purchased water, purchased power and pump taxes.
    a. The costs of purchased water, purchased power and pump taxes associated with the production of water can vary due to changes in unit cost or consumption amount.

2) In particular, the MCBAs will track the difference between Actual Variable Costs and Adopted Variable Costs for the following variable costs (which are recovered through the quantity charge under both the current and proposed rate designs): purchased water, purchased power, and pump tax.

3) An MCBA will replace each of the current balancing accounts, now referred to as Incremental Cost Balancing Accounts (ICBAs)
    a. CWS currently has ICBAs for purchased water, purchased power, and pump taxes.
    b. ICBAs track cost changes attributable to changes in unit price, and not to changes in the amount of consumption.
    c. MCBAs track cost changes attributable to all changes in consumption (including changes in unit price).

IX. RECOVERY AND REFUND OF BALANCING ACCOUNTS

1) Parties agree that conservation rates may cause the amount of water consumed, and thus the cost of water production, to vary significantly.

2) Parties agree that the desired outcome and purpose of using WRAMs and MCBAs is to ensure that the utility and ratepayers are proportionally affected when conservation rates are implemented.
    a. In the context of this agreement, a proportional impact means that, if consumption is over or under the forecast level, the effect on either the utility or ratepayers (as a whole) should reflect that the costs or savings resulting from changes in consumption will be accounted for in a way such that neither the utility or ratepayers are harmed, or benefit, at the expense of the other party.

3) Parties agree that, in each district, the balance in the WRAM will offset the balances in the MCBAs computed as follows.
    a. Reporting Requirements: By March 31st of each year, CWS will provide the Water Division (with a copy to DRA) a written report on the status of the WRAM and MCBA as described herein.
    b. WRAM: CWS will provide the Water Division with a written report that includes a section on the WRAM in each district showing the revenue over- or under-collection with respect to actual (or recorded) water sales as of December 31st of the preceding calendar year. Differences between actual revenues and adopted revenues will be tracked in the WRAM and accrue interest at the 90-day commercial paper rate.
    c. MCBA: CWS will also include in the report it provides the Water Division a section on the MCBAs in each district comparing actual costs with adopted MCBA costs as of December 31st of the preceding calendar year. Differences between actual costs and adopted costs will be tracked in the MCBAs and accrue interest at the 90-day commercial paper rate.
    d. If this report shows that the combined over- or under-collection for the WRAM or the MCBAs in any district exceeds 2.5% of the district's total recorded revenue requirement for the prior calendar year, CWS will file an advice letter within 30 days that amortizes the balance in all of the accounts.

4) Surcharges and surcredits: Recovery of under-collections and refunds of over-collections will be passed on to ratepayers through volumetric surcharges and surcredits based on the quantity of consumption.

5) In each general rate case filing, CWS will request amortization of any remaining amounts in the WRAM and MCBAs.

X. MAINTAINING LEAST-COST WATER MIX

1) With regard to changes in the water mix that result in changes in variable costs tracked in the MCBAs, CWS stipulates that it will exercise due diligence in ensuring the least-cost water mix of its water sources.

2) If there are significant changes in purchased water in a district that has multiple sources (which in turn affects the amount of purchased power and pump tax):

    a. CWS will make a showing in the district's next GRC filing demonstrating that it has exercised due diligence in ensuring the least-cost mix for its water sources, and that the significant change in water purchases was reasonable.
    b. For the purpose of this Trial Program, significant changes in a district are defined as when the annual volume of purchased water is greater than 10% of the purchased water adopted in the most recent GRC for that district.

XI. SCHEDULES

1) Attachment 1 provides information for each district in which conservation rate designs are proposed for residential customers. There are five worksheets for each district. (The names of the worksheets correspond to the districts. The worksheets appear alphabetically. For example, Bakersfield is the first district that appears in the documents for Group 2.) The names of the worksheets for the Bakersfield district are provided as examples.

    a. Worksheet 1 shows what residential customers will experience under the water conservation rate design as compared with the uniform single quantity rate for their total bill (consisting of the meter charge and the quantity charges). In particular, this worksheet shows the dollar and percent changes in total bills (at different consumption levels) comparing the current rate design to the proposed rate design. (Example: "Bakersfield.")

    b. Worksheet 2 shows what residential customers will experience under the water conservation rate design as compared with the uniform single quantity rate for the volumetric-based (quantity charges only) portion of their bill. In particular, this worksheet shows the dollar and percent changes in the quantity (volumetric-based) portion of bills (at different consumption levels) comparing the current rate design to the proposed rate design. (Example: "BQOnly.")

    c. Worksheet 3 is a chart (or graph) showing the change in the total bills for residential customers, comparing current and proposed rates. (Example: "BC1.")

    d. Worksheet 4 is a chart showing the average unit cost at various consumption levels, comparing current and proposed rates. The average unit cost is defined as total quantity (volumetric-based) charges divided by usage. (Example: "BC2".)

    e. Worksheet 5 is a chart showing the marginal cost curve of the proposed rate structure (the unit rate as it changes from tier to tier). The chart graphically depict the steps in the rate structure as the price by block changes. (Example: "BMC.")

2) Attachment 1 also includes information for each district in which conservation rate designs are proposed for non-residential customers. There is one worksheet for each district. The worksheets are named by district (for example, "Chico," which is the first district that appears in the documents for Group 2).

    a. The worksheet shows what non-residential customers will experience under the water conservation rate design as compared with the uniform

single quantity rate for the volumetric-based (quantity charges only) portion of their bill. In particular, this worksheet shows the percent changes in the quantity (volumetric-based) portion of bills (at different consumption levels) comparing the current rate design to the proposed rate design.

3) Attachment 2 provides information for each district in which conservation rate designs are proposed. There is one worksheet for each district. Each worksheet shows:
    a. A box showing current and proposed rates and number of customers and water consumption in Ccf.
    b. A box showing customers and consumption blocks including cumulative data along with statistical indicators labeled 'rationale.'
    c. A box showing proposed rate design revenue by block and including an estimate of over or under collection.

XII. MONITORING AND DATA COLLECTION

DRA and CWS will develop a Memorandum of Understanding prior to implementing the increasing block rate design to address the collection of data, such as billing and usage data by meter size by month, class of customer, for use in analyzing customer response to increasing block rate design.

XIII. RETURN ON EQUITY

1) The Parties were not able to agree on CWS' assertion that:
    "Given the Commission's policies in implementing revenue decoupling for energy utilities, the Commission should not impose a return on equity (ROE) adjustment with implementation of revenue decoupling for water utilities."[10]

2) Parties agree that the impact of the Trial Program (decoupling and conservation rate design) on ROE is not part of this settlement.

3) Parties agree to defer to the Commission's decision on any impact on ROE if at all.

[10] Prepared Testimony of David Morse on Decoupling Revenues, Conservation Programs, and Rate Design Policy (October 23, 2006) at 21.

Respectfully submitted,

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